The high road that leads out of the Low Countries

Many people think that recent economic reforms in the Netherlands—which faces a new election after its government broke up this week—offer a successful halfway house between Anglo-American free markets and continental welfare states. Frits Bolkestein, a leading Dutch politician, begs to differ. More liberal reforms are needed, he argues—everywhere in Europe

IN JUNE 1997 President Bill Clinton lauded the Dutch model of economic policy as a "success story". It deserved imitation, he said. Economic editors of most international newspapers also praised the economic performance in the *polder* behind the dykes. They wrote about "The third way" (*New York Times*), our "sturdy neighbour" (*Wirtschaftswoche*) or a "Dutch cure" (*Die Zeit*). This newspaper called it "Dutch delight".

Such favourable comments refer to the above-average economic growth (compared with other member states of the European Union), the increase in employment, the low rate of inflation and the reduction of the budget deficit. According to these foreign commentators, this economic performance stems from a number of characteristics typical of the Dutch economic order. It has even been given a name: the *poldermodel*. But opinions differ on what that concept means. This article attempts to explain such ambiguity, and explore its consequences.

To do that, it needs to answer the following questions: (1) Which variants of capitalism exist? (2) What are the characteristics of the Dutch economy? (3) How successful is that economy in fact? (4) What more should be done?

Of models and capitalisms

In his well-known book "Capitalisme contre capitalisme", a former director of the French planning agency, Michel Albert, made the following distinction. On the one hand, he said, there is a continental, West European type of capitalism (the "Rhineland" model); on the other an Anglo-Saxon capitalism (in Great Britain and the United States of America).

The Rhineland model may be seen as a regulated market economy with a comprehensive system of social security. Government, employers' organisations and labour unions consult each other about economic goals and on the policy instruments to be used. In the Rhineland, therefore, the welfare state is combined with a so-called "consultation economy".

Rhineland participants in the economic process (widely known as "stakeholders") try to achieve a harmony of interests. In such a stakeholder economy the primary goal, it is said, is not the maximisation of short-term profits for the benefit of the shareholders. The main concern is a sustainable, stable and continuous economic growth.

In contrast to the stakeholder economy there is the American or Anglo-Saxon "shareholder economy". Under the American form of capitalism, private enterprise is about maximising short-term profits for those who invest. It is less regulated than in the Rhineland. Its focus is said to be not on any harmony of interests, but on competition and if necessary confrontation. In going for profits, Americans are more willing to take risks. Where Europeans may be risk-avoiders, Americans are risk-lovers. Under the Anglo-Saxon type of capitalism individual responsibility plays a more important role than in the Rhineland, with its organised care and solidarity. In the Netherlands, the Social and Economic Council (an advisory semi-corporatist council for social and economic affairs) and the Labour Foundation (a council for employers' organisations and unions) have fulfilled important functions. Employers' organisations and unions are called "social partners".

Many in the Netherlands attribute their success to harmonious relations between these social partners. They appear to think that this is what the *poldermodel* boils down to, both in the past and in its recently modified form (of which, more later). The previous minister of social affairs—a social democrat—said "*Ich bin ein Rheinländer.*" Certainly such good relations play a role. But it is other factors which have caused the *poldermodel*'s recent success.

In the view of Wim Duisenberg, a Dutchman who is now president of the European Central Bank, the success of the Dutch economy stems from: an improvement in state finances; a pruning of the system of social security; a more flexible labour market; and a stable exchange rate between the Dutch guilder and the German mark.

It has been claimed that the so-called Wassenaar Agreement of 1982 has made Dutch success possible. At Wassenaar, a suburb of The Hague, employers' organisations and unions reached an agreement on wage modernisation and the creation of jobs. But this agreement in fact led to an erosion of the Rhineland model. It brought centralised wage bargaining to an end and led to a release of market forces. Decentralisation was a move away from the consultation economy and towards the market.

Tax cuts played an important part in wage moderation. They increased people's purchasing power and thus made it possible to limit increases in wages. Wage moderation has therefore not led to a shortfall in demand, as originally feared by some. The tax cuts coincided with a decrease of the budget deficit as a percentage of national income. Both were made possible by a sizeable reduction of public spending following upon restrictions in social security. Between 1980 and 1997 the purchasing power held by those on the minimum wage went up by 28.8% in France. In the Netherlands it went down by 21.3%. Hence the remarkable growth in jobs. Annual increases in Dutch jobs have averaged 1.6% over the past 15 years. That is four times the European average and is equal to the American employment machine. Cutting taxes, not raising them, is the way to create jobs.

Moreover, the Dutch welfare state has become increasingly unDutch. Cuts in public spending were heavily criticised by the unions and applauded by employers' organisations. The biggest post-war union demonstrations took place in the early 1990s in protest against them.

The success of the *poldermodel* was in fact made possible by a decisive break with the traditional semi-corporatist welfare state. The power of social partners to man-

BY INVITATION

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age social security was broken. The Social and Economic Council became a mere shadow of its former self. It was no longer the crown jewel of policymaking machinery.

The Rhineland model was thus not strengthened: rather the contrary. The reduction of the tax burden owing to the slimming of public finance; the policy to stop matching any increase in wages with an equal increase in minimum social benefits; the decentralisation of collective bargaining agreements; the reduction of benefits for the disabled; and the privatisation of health insurance: all these went against the grain of consensual politics.

But how much success has the Dutch economy actually had? First, one can measure it by GDP per head. According to Eurostat, in 1998 the Netherlands was still only ninth among the 15 European Union countries. Second, employment. Job opportunities for low-skilled people remain scarce. In the retail trade, American employment figures are 60% higher than Dutch ones. Also, notwithstanding low official Dutch unemployment (on this, the Netherlands scores better than Germany, France and Italy), inactivity remains high. If statistics were to take into account all those who are able to work but who receive social benefits instead, unemployment figures would rise to over 20% of the labour force.

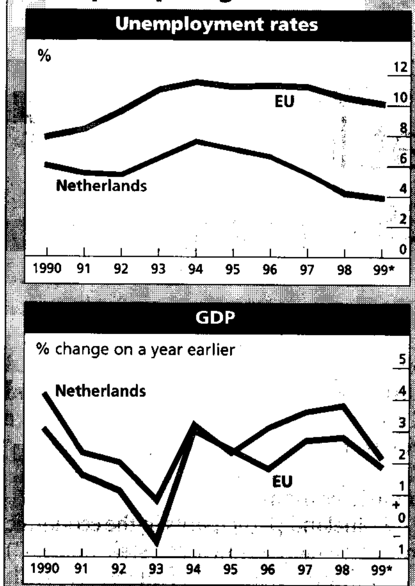
Viewed in this light, the recent success of the Dutch economy is merely relative to a worse past. Of course, improvements have been made. The share of public expenditure in national income was 66% in 1985. Now it is 50%. The government has made social security less collective by allowing privatisation and introducing market elements. In so doing, it has supported the setting of wages in private markets. It has also invested in infrastructure. But a favourable trade cycle helped too. More structural reforms are needed to improve Dutch performance and increase participation in the labour market.

The case for further liberalisation

In 1997, consultants at McKinsey published a report on the Dutch economy. Four important barriers were seen to play a key role in keeping the Netherlands behind other countries. First, a lack of competition. Consumer goods are approximately 20% more expensive in the Netherlands than in the United States. Higher margins signify less competition. Dutch legislation on competition has in the past been relatively lax. Recently the Dutch government passed a new law on competition which sets stricter rules. To boost growth the Netherlands will have to enforce those rules vigorously.

The second barrier is formed by labour-market rules, including those on working hours and on hiring and firing, and by stringent collective bargaining agreements. In the OECD Jobs Study of 1995 a ranking was made of the extent of labour market regulations, in which the Netherlands scored worse than the United States, Britain, Denmark and Japan. On a scale from 0 (over-regulation) to 10 (very little regulation), the Netherlands scores 4 points against the United States' 7.

Europe's paragon?



Source: OECD *Forecast

The third barrier has to do with the unattractive climate for setting up new companies in what are or should be fast-growing sectors. Strict regulation drives up labour costs. This is particularly true for small businesses. A recent international comparison of administrative costs in eight countries (including Germany and the United States) shows that the cost of hiring the first employee are highest in the Netherlands.

The fourth barrier consists in the lack of incentives for the low-skilled to find jobs. Social security benefits in the Netherlands are still among the most generous in the world. Many of the unemployed are therefore stuck in a poverty trap. Wider margins between benefits and wages should lead to jobs becoming available for those who can work but now depend on social security.

These recommendations imply that the Netherlands should keep moving in the same direction as in the past few years. Through deregulation the functioning of market mechanisms should be further improved and social security trimmed. In particular, the government must get a grip on the mounting number of registered disabled, of which there are many more in the Netherlands than in Germany or Belgium. Officially, 13% of the working population is now disabled. If a genuine figure, that would make the Netherlands the unhealthiest place in north-west Europe, despite having the highest life expectancy.

In short, the Dutch economic order will have to move even further towards the Anglo-Saxon model of capitalism. Policies which point in that direction have begun to bear fruit. And such policies should not be construed, as many choose to, as a reinforcement of the Rhineland model. Quite the contrary.

If the Netherlands still has a long way to go, that goes even more for those European countries which are still firmly stuck in the Rhineland rut. France's prime minister, Lionel Jospin, has proposed public works projects as an answer to unemployment. But such projects are financed either by raising taxes or by increasing the budget deficit. In the first case the number of jobs created by the additional public works will be smaller than that of jobs lost in the rest of the economy. Governments which want to avoid this problem by deficit financing will run into the obstacle of EMU's anti-deficit rules.

European unemployment is a man-made disaster. Policy harmonisation would cause this blight to spread. At the European summit in Austria last autumn, the chancellor of that country, Viktor Klima, said that co-ordination of economic policies was "the key to creating employment". Such calls are usually supported by governments which espouse unsuccessful policies. They say they fear that tax rates will suffer a race to the bottom. Harmonisation, though, is more likely to result in a race to the top. Altogether, it would lessen the pressure to carry out necessary but unpopular structural adjustments to the welfare state.

In order to make the euro work, more flexibility in the labour market is needed since the instrument of devaluation no longer exists. Rhineland governments are uneasy about this—if not downright hostile. By creating the euro they have thus made a stick for their own back. They must either deregulate or infringe the rules of the EMU. But this thought has yet to sink in.

Should the Netherlands go all the way? Should it change to the type of market economy that exists in the United States? The Anglo-Saxon model has its own problems. Maximising utility in the short term leads to too few savings and insufficient investment. Americans have not invested enough in public provisions like infrastructure and education. In the Rhineland, savings are considerable and investments are on an altogether higher level. Social security will have to be trimmed but the essentials of the system can be retained, provided public expenditure is kept durably under control.

A synthesis of the Anglo-Saxon and Rhineland models ought to be possible. A "Mid-Atlantic" model really would unite the positive elements of both. But that model has not yet been reached in the Netherlands. More liberalism is required if the Dutch economy is to achieve its potential and to raise living standards—and the same applies to the rest of the European Union, but even more so. ■